

European Court of Justice Delivers Mixed Message on Parallel Trade

October 6, 2009

The European Court of Justice (ECJ) issued its long-awaited decision in C-501/06 P *GlaxoSmithKline Services v. Commission* today (October 6, 2009). The ECJ overturned the European Commission's (EC's or the Commission's) decision that GlaxoSmithKline's (GSK's) dual pricing policy violated Article 81 of the EC Treaty on procedural grounds but made clear that policies designed to limit parallel trade within Europe are presumptively illegal.

Parallel trade has been a perpetual thorn in the side of pharmaceutical companies operating in Europe. The price at which pharmaceutical companies can sell their products is directly or indirectly regulated in most European Union (EU) Member States. This creates arbitrage opportunities for wholesalers, who purchase pharmaceuticals in Member States where the price is set low (e.g., Spain or Greece), and resell them in higher-price countries (e.g., Germany or the UK).

The Commission has successfully challenged most efforts by pharmaceutical companies to prevent arbitrage and limit parallel trading within Europe. The Commission has argued that such practices violate Article 81 and/or Article 82 by unlawfully restricting trade between EU Member States. The Commission's enforcement policy is largely driven by the EC Treaty's underlying objective of integrating markets by breaking down public and private barriers to trade between EU Member States. In the pharmaceutical sector, the Commission's policy has been criticized because differences in Member State health care legislation prevent price convergence, and thus parallel trade simply results in a transfer of profits from manufacturers to wholesalers without any significant gains to European consumers.

In the case at hand, GSK had adopted a dual-pricing mechanism in its Spanish distributor agreements, under which it charged them the statutorily fixed price for pharmaceuticals that would be resold in Spain, and a higher price for pharmaceuticals that would be sold outside of Spain. GSK notified the agreement to the European Commission for a decision either (i) that the provision did not restrict competition and therefore did not fall within the Article 81(1) prohibition against agreements that have the object or effect of restricting competition or (ii) that it satisfied the conditions for exemption from the prohibition under Article 81(3).¹ The Commission found that the agreement infringed Article 81(1) because its object was to restrict trade between Member States, and that it did not provide any procompetitive benefits justifying exemption under Article 81(3).

¹ The notification procedure that GSK relied on was abolished when Regulation 1/2003 entered into force in May 2004.

GSK appealed to the European Court of First Instance (CFI), which partially annulled the Commission's decision for failing to adequately consider GSK's arguments that restricting parallel trade increased the amount of funds available for research and development benefiting consumers. The CFI also held that the Commission erred in concluding that the agreement had a restrictive object, because there was no evidence that the final consumer would be harmed by what was essentially a wealth transfer between the manufacturer and wholesaler. However, the CFI held that this was immaterial, because it was undisputed that the agreement had the effect of restricting competition. All parties appealed the CFI's decision.

The ECJ upheld the CFI's decision, agreeing with the CFI that the Commission had not adequately addressed GSK's arguments on Article 81(3). However, the ECJ repeatedly emphasized that the role of the courts is limited to ensuring that the Commission has met its procedural obligations, and that they will not second-guess the Commission's economic assessments. In other words, the Commission would have been free to reject GSK's arguments; it just needed to explain why it rejected them.

Two elements of the decision have broad implications for the application of Article 81 going forward:

- The decision clarifies the standard of proof for invoking Article 81(3). It is not necessary, as the Commission had argued, to prove that an agreement *will* result in procompetitive benefits for consumers. The Article 81(3) standard will be satisfied if it is more likely than not that the agreement makes the attainment of procompetitive benefits possible.
- The ECJ indicated that consumer protection is not the paramount objective of EC competition law. The ECJ found that the CFI erred in holding that parallel trade restrictions did not have the object of restricting competition if the restrictions would not lead to consumer harm. The ECJ stated: “[T]here is nothing in [Art. 81] to indicate that only those agreements which deprive consumers of certain advantages may have an anti-competitive object. . . . Article 81 EC aims to protect not only the interests of competitors or of consumers, but also the structure of the market and, in so doing, competition as such.” This lends support to those who argue that the policy objectives of U.S. and EC competition law continue to diverge.

The implication of today's ruling is that contractual provisions intended to limit parallel trade are presumptively illegal. Given the tremendous discretion given to the Commission, pharmaceutical companies and other companies dealing with market distortions caused by differences in national regulation will face an uphill struggle in rebutting that presumption.

Moreover, companies need to be very careful in taking unilateral measures to limit parallel trade. The Commission's recent draft revisions to its *Guidelines on Vertical Restraints* make clear that the Commission will aggressively construe as restrictive agreements situations where distributors are “coerced” into limiting parallel trade for fear of retaliation. Even where unilateral acts cannot be construed as implying an agreement, pharmaceutical companies need to be careful that they do not inadvertently violate the Article 82 prohibition against abusing a dominant position. Patents create barriers to entry that make it easy for regulators to prove dominance. Dominant pharmaceutical companies must ensure that any unilateral steps they take to limit parallel trading are proportionate to their “legitimate” commercial interests, and they may not completely eliminate parallel trade in their products (see the ECJ's recent decision in Cases C-468/06 to C-478/06 *Sot. Lelos kai Sia EE v.*

GlaxoSmithKline AEVE).

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